

THE ALDRICH-VREELAND BILL, AND ITS PLACE.

BY THEODORE GILMAN.

Now that the method of issuing bank currency through voluntary corporations composed of associated national banks has been made part of the banking laws of the United States, by the enactment of the Aldrich-Vreeland bill, with the object of preventing monetary panics, it devolves upon those who approve of the principle of the measure to show its place in republican banking legislation, and to establish its claim to be wise, safe and efficient. This law is without precedent, because never before in the history of the financial world has there been an attempt to construct a banking system of, by and for the people. A departure from precedents, especially in banking methods, is so unusual as to constitute an era in banking; and it is well to pause at the threshold of the subject to inquire into the reasons for this radical change. Does it stand the test of the principles laid down by the authorities? Is it in the nature of an experiment and above all can it be justified by experience?

1. The currency question is a practical one. That is, its solution must be arrived at by experience, and not by theories. After two hundred years of experience, the nature of credit is as well understood as the properties of steam, gravitation, electricity or any other power. The necessity for safety valves, buffers and insulators is the same now as when steam, gravity and electricity were first harnessed. The necessity for reserves is the same now as when, in 1697, the Bank of England suspended cash payments because it was attempting to do business on a cash reserve of less than three per cent. of its demand liabilities. The rule of probabilities, on which the credit system is based, works approximately the same now as it has worked at any

time during the last two hundred years. It is true now as it always has been that there are probabilities which govern ordinary and extraordinary circumstances. These aspects of the currency question have been discussed for centuries by practical business men, lawmakers and economists of the greatest ability and clearness of perception; and it must not be thought that anything new can be said on the subject which has not been said before. Nor should it be expected that any new plan, or device, or experiment can be suggested which has not been tried or elaborated or proposed at some time in the past. The currency question is all of one piece, from the time the credit system was established in 1694 by the founding of the Bank of England, down to the present time. The laws of credit cannot be violated now with less chance of punishment than at any previous time.

The situation of our currency discussion, in and out of Congress, has been called a chaos, and it is so only because every scheme, meritorious or worthless, which has been promulgated during the past two centuries, has had an advocate now and all these voices have joined in the general hubbub. The practical method of testing by experience will make short work with many of these plans. There is the history of the French assignats, of the South Sea Bubble, of government fiat money in England and the United States, of uncontrolled bank-note currency which produced the panic of 1837, of the English panics of 1847, 1857, 1866 and 1890, and our own of 1873, 1893 and 1907, all giving a fund of experience by which to rectify past mistakes and guide future action. There are also, to be used as warnings, the instances where false theories have been incorporated into a country's banking system, like those in the English bank charter of 1844 and like our own bond-secured currency of 1861, which can with difficulty be got rid of even after their falsity has been exposed and acknowledged for decades. There is no lack of painful experience which has burned its evil effects into men's minds by untold disasters. There have also been favorable experiences of good systems of banking, which have been of the greatest benefit to the countries served by them, of which the chief example is the French. There have been important principles established by the long currency discussions in our country, which must be preserved as absolutely essential under a free republican form of government. The practical method in considering these cases

affords the surest and best guide by which to arrive at sound and correct conclusions, for that will lead us to take the course which has been proved by experience to be productive of good results and to shun the path which has brought us or any other country to trouble.

2. As the settlement of our currency question is a practical matter, we must look for the reasons why our banking system has worked badly. The times when it works well are not under consideration. The question should not be what was the cause of any particular one of the panics which have swept over our country, but, was there not a cause which was common to them all? There has been no change in our national banking system since 1861, and therefore the inquiry may be properly limited to that period. It is pertinent, then, to ask why our system has not carried us over those years from 1861 to the present time without monetary disorder. During those forty-seven years, France has had no money panic, though it has experienced severe commercial convulsions. Its capital, even, was occupied by a foreign army, and it paid an enormous indemnity to free itself from the presence of the enemy. The business troubles of France have been as great as ours, or even greater—to wit, the collapse of the copper syndicate in 1880, and the failure of the Panama Canal Company. New York has not been occupied by a foreign army in that time, and we cannot claim that our circumstances are exceptional and afford a satisfactory explanation for our many breakdowns. The fact remains that the French system protected that country from money troubles, while our system has not protected us.

We cannot ascribe our money panics, therefore, to anything outside of our banking system. It is the kind of system we are working under, and not the kind of business we are doing, which is the cause of our panics. The defect in our system is simple and the mode of relief is simple. The defect was pointed out at the time the New York law of 1838 was enacted, after which our National Bank Act was modelled in 1861. It is no new thing. The defect is, perhaps, described best in the edition of the "Encyclopedia Britannica" of that time. It is that, when a demand for money arises, it must be met from reserves of lawful money, because a bond-secured currency does not respond to the demands of business. Each draft on the reserves entails a reduction of

about three times as much credit. The process is like taking away the foundations of a house. When enough of it is taken away, the superstructure must collapse. The only way to protect reserves under our present system is by calling in loans and refusing to renew accommodations. This puts a pressure on borrowers, who thereupon seek loans in the open market at rising rates of interest. The money to grant these loans is withdrawn by private lenders from the banks, which withdrawals still further reduce their reserves and compel them to increase their demands on borrowers. If at the same time alarming events occur, the public become excited and distrustful and begin to hoard currency, knowing that reserves are inadequate and a suspension of cash payments is inevitable. The National Bank Act gives no relief, for under it the banks can protect their reserves only by forcing liquidations, and the process must go on, unless the banks can get outside relief, until the demand for money is lessened by the prostration of business. So it is evident that the legal way under our present system to protect the banks is by methods which cause panics.

This is the so-called restrictive system and is in vogue in England and the United States. Under this system a panic is ended by the exhaustion of borrowers and the stoppage of business, or by methods outside of the law. The restrictive system is incorporated, and it may be said concealed, in the 95th section of the National Bank Act, where it is prescribed that, when the reserves of a bank are impaired, it must not increase its loans, and if the reserves are not restored in thirty days, a receiver for the bank may be appointed. To restore reserves, a bank must decrease its loans. The correct name for such a system of banking is the "Panic System," and certainly our national act has earned that title in the past forty-seven years, for in that time we have had lesser panics almost every year and full-blown panics at regular intervals.

3. It is very evident that the simple remedy for this defect is to create some source to issue a credit currency to meet these temporary demands on the banks, so that they may retain their reserves undiminished and not be compelled to call loans and afflict borrowers. This is called the "Expansive System." It is no new suggestion, for it was made by Sir Francis Baring in 1797, by the Bullion Report in 1810, by Robert Hare in 1837,

by Henry Dunning McLeod in 1893 and by many others. The history of finance in this country and elsewhere shows that money panics have all been caused by the operation of the restrictive system, and they have been cured, from the first recorded modern panic of 1793 to the present day, by the expansive system. The principle of the expansive system was successfully incorporated into French banking by the short and easy method of conferring a monopoly of issue on the Bank of France. But a monopoly is odious in the eyes of Anglo-Saxons, and the attempt to adopt the expansive system in our country by the establishment of a United States Bank met its Waterloo in the conflict with our principles of popular government and individual initiative. The United States Bank was not destroyed because it was inefficient and failed of its object, but because it was not in harmony with our free institutions, and one or the other had to go.

The next step in our banking history was a fatal one. The power of issue was allowed to independent State banks with no central bank to which they might appeal for aid. This was an unconscious abandonment of the expansive for the restrictive system. The lawmakers of that time did not know what a dangerous step they were taking or what frightful consequences would result therefrom. Business was prosperous for a while; but, when distrust came, there was no way by which the banks could protect themselves except by the restrictive method of forcing liquidations. The outcome was the severest example of the results of the restrictive system the world ever saw. The losses were estimated at six thousand millions of dollars. The losses on banking capital were stated by the United States Almanac for 1843 to have been \$248,000,000, and on bank circulation and deposits \$54,000,000. The annihilation of values was almost inconceivable. At sheriff's sale in Ohio, horses were sold at two dollars each, cows at one dollar each, and in Missouri sheep at thirteen and a half cents each, a large ox at twelve and a half cents, twenty-four hogs at twenty-five cents for the lot, stacks of hay at twenty-five cents each, and so on. As a result of forced liquidations of all kinds of property and consequent prostration of business, much of the bank currency was paid, after considerable delay, at par. It was made good at the expense of a holocaust of credit and values.

It must not be supposed that these troubles came upon this country because of prevailing ignorance of the subject of credit, and for lack of sound opinions and good advice. It is sufficient to cite the suggestion of one financial writer. When the supporting power of the Bank of the United States was taken away by President Andrew Jackson, and the power of issue was given to many independent banks, Robert Hare* published in Philadelphia a pamphlet, dated 1837, inscribed to Mahlon Dickerson, Secretary of the Navy, in which he showed the necessity of some scheme to support the banks in an emergency. He wrote as follows:

"I would have the existing banks, or as many as would concur, to resolve themselves in their individual capacity into offices of deposit and discount, and in their joint capacity into a general loan office, under the authority of the national Government. In one capacity, they are to relinquish all right to issue loans on personal security or to receive deposits subject to order; in their separate capacity, they are to relinquish all right to issue bank notes or bills of credit payable to bearer or any form of bank notes or paper credit which enter into circulation so as to act as money without endorsement. Thus the branch offices will become the progenitors of the general office, instead of the general office being the parent of the branch offices. No member of the association can issue notes for which he does not previously give security. The national circulation would not be under the control of one corporation, a predicament so objectionable to many, but under the control of trustees appointed by the confederated banks, and the duties of these trustees defined both by the deed of trust and the laws under which it should be executed."

If this simple plan had been carried into effect, we would have had an expansive system of banking which would have protected this country from the panics which have occurred in the past seventy years. The combination would have been like the Hanseatic League of the twelfth century, which is said to have protected the commerce of the Hanse towns without a failure for two centuries. But the times were not ripe for such a scheme, for banks were not then accustomed to associate themselves in clearing-houses, and the lawmakers of that time in Congress made banking a football for politics, instead of a practical business proposition.

* Robert Hare, 1781-1858. An American writer on scientific, financial and other topics. He was a friend of Priestley, Seybert and Woodhouse. The American Academy of Boston awarded him the first Rumford medal for his inventions. Yale College gave him an honorary degree. He was a man of marked ability and influence.

4. After both the central bank and the independent bank schemes had been discredited, there came a revulsion of sentiment against all banking, and banking was prohibited in some States. It seemed that barter and bullion afforded the only satisfactory way of conducting business. But the demands of modern life asserted themselves, and a forward effort was made to bring banking into conformity with the spirit of freedom which animated and controlled all hearts. Then was done pioneer work in the untried field of republican banking legislation. The two principles which were established by the discussions which followed 1837 were, first, that special bank charters should cease and that banking thereafter should be done under a general law; and, second, as a necessary consequence of the creation of many independent banks, that the power of issue should be separated from the ordinary functions of banking and that banks must deposit security with an officer of the State for all currency issued by them. Legislators saw that in no other way could a general law safely be framed that was to be free and open to all. The temptation to an unwise use of the power of issue was one which even the directors of the Bank of England could not resist, much less the directors of hundreds of small banks in the United States. The act of the legislature of New York in 1838 embodying these principles was hailed at the time as a new declaration of independence.

Thus free banking and the securing of bank currency with property in the hands of a trustee, were established as the cornerstones of republican banking. It is to be noticed that these two principles were not intended to abrogate the principle of expansion as the true means of meeting and controlling monetary troubles. They were rather the necessary steps in the growth and development of republican legislation on the subject. At the time it was expected that the secured currency would expand and contract to meet the wants of business; but the object chiefly aimed at then was to make the currency safe by a pledge of collateral. The defect of inelasticity, as has been said, was seen and commented on immediately on the passage of the New York law of 1838.

When the National Bank Act was framed in 1861, it of necessity followed the New York law of 1838 on the two points named. It was a general law which provided a secured cur-

rency. Congress would have stultified itself if it had followed any other model. The security, however, was changed from municipal bonds and real-estate mortgages to bonds of the United States. That the two principles are good is shown by the successful operation of the national banks, and that there has never been any question as to the goodness of the national bank currency. The only criticism is the old one, that the currency does not respond to the demands of business and that those demands must be responded to by squeezing borrowers.

5. Basing their objections on this one defect of inelasticity, there are those now who would wish to see the expansive system re-established by abandoning both the cardinal republican principles of a general law and a secured currency. They would give up the general law and go back to the branch banking system, or to a central bank with a special charter. They have proposed a "frank abandonment" of security for currency, and in some way or other to allow banks to issue currency on their own responsibility. These proposals have been advocated with a tenacity of purpose and a wealth of resource which proves that those who support them are terribly in earnest. There is only one reason why these efforts, on which so much time and money have been lavished, have not been successful. That is that, deep down in the heart of the American people, there is an ideal of the basis of our government; and the people recognize, and their representatives recognize, that a central bank, or a branch banking system, or a currency issued on the responsibility of individual banks, does not conform to that ideal.

In a republic, the people govern, and all authority delegated by them is delegated for a set period, at the end of which it must be returned and surrendered to them. The Government is the servant and creature of the people, not their master. If that principle does not enter into the fundamental law of a land, its Government is not republican. A banking system in a republic must partake of the same political character as the Government. Our people approved of separate individual banks because they were free and independent. To any proposal which would take away that independence, the country simply answered "No." But when Congress, out of the many plans before it, selected the one creating associations of banks, which associations were the creatures and servants of the banks composing

them, whose officers held only delegated authority, which was after short periods to be returned to the associated banks, then the country saw that this was the republican idea carried into banking. Such associations are diametrically opposite in principle to a central bank, and this explains why the Republican party voted nearly unanimously in favor of the Aldrich-Vreeland bill.

The main provision of this bill is that only associations representing groups of banks shall issue bank currency. It is evident that the sovereign power to create money or currency should not be delegated by Congress without the most perfect guarantees that it will not be abused. The only method thus far devised in any civilized country to secure such guarantees is to separate the functions of issue from those of deposit and discount. That is the principle established by the New York law of 1838, by the National Bank Act of 1861, and it is now perpetuated in the Aldrich-Vreeland bill of 1908. In France, there are thousands of popular banks, many with large capital; but only one institution has the power to issue—the Bank of France. If a local bank in France, like the Credit Lyonnais, which has a capital of \$40,000,000, should need currency on account of a local financial disturbance, or from any other cause, it must send to the Bank of France acceptable securities in the shape of bills receivable or convertible bonds and stocks, and ask a discount. If the collaterals are approved, the Bank of France would immediately forward its notes for the proceeds of the discount. The separation of the two functions in France, as far as the popular banks are concerned, is thus complete. In Germany, there are also thousands of popular banks, but only half a dozen with the power of issue. It is expected that the power of issue of these half dozen will in time be absorbed by the Imperial Bank. Thus in Germany, also, the separation of the two functions is complete. These two nations have not enforced this separation without reason or a struggle. The *reason* is that directors of local, popular banks cannot be restrained within conservative limits in the exercise of the power of issue. The temptation of profit has beclouded, and always will overcome and becloud, judgment. The *struggle* was to force the popular banks to relinquish the right of issue, which was accomplished by drastic governmental measures. The history of banking in every civ-

ilized country, during the past century, shows a succession of acts limiting the power to issue bank currency within increasingly narrow limits. Separation of the function of issue from those of deposit and discount induces caution and conservative action. The popular bank must submit its collateral securities to the inspection of the association, which is the bank of issue. The latter takes the risk of the loan and will require the best the popular bank can give. The security has first been approved by the popular bank and then is reviewed by the bank of issue. There is no safer use of money than in such loans; and, consequently, the Government can safely delegate to an association of banks the power to create currency for popular use, when the loans on which it is based are made in this careful and conservative manner.

6. It has been said above that the remedy for our currency troubles is simple. The Aldrich-Vreeland bill shows how simple the method is. The National Currency Associations provided in that bill would occupy towards all national banks the position of the Bank of France towards the local banks of that country. The position would be even a better one; for the Bank of France, through its branches, competes with all French banks for local and national business, while currency associations would not do a general banking business. The evils of centralization, under which the provinces groan, would be avoided. In discussing the Aldrich-Vreeland bill, we must assume that Congress will abolish the almost prohibitive and unnecessary tax on circulation of from five to ten per cent. Congress constructed a fine machine with all necessary safeguards, and then clogged the wheels. If only Congress will take off the clogs, the country can then see how the machine will work. Assuming that the five to ten per cent. tax is removed, it is evident that, when the time of year comes for moving crops, interior banks in the crop sections would apply to their National Currency Associations for loans of currency. In anticipation of these demands, the associations would have on hand a supply of currency ready for issue. Immediately on approval of the securities offered, the notes would be forwarded to the interior banks asking the loans. Thus, without any pressure on the commercial communities in Eastern cities, and without causing any rise in the rate for money, the enormous crops of our country would be moved to market and the initial

business operation of the year would be completed. Banks in the East would not be called on for currency, as it would be supplied where the demand originated. Thus one trip across the country would be saved. All that is required of Eastern banks by the bill is to accept the currency at par, when it would be charged up to some account or redeemed at Washington, and on the trip back it would be a cancelled voucher. The present cumbersome method of sending the currency on a trip of from one to three thousand miles would be avoided. The issues by banks in central cities would thus be small.

The principle of the bill is co-operation. Ex-Secretary Shaw said, in his last report to Congress, that he was repeatedly informed that co-operation was impossible. Who made that remark, the Honorable Secretary did not state. It would be well if the country knew. It is evident that co-operation was impossible before this bill was enacted. The restrictive system is one of internecine strife or civil war. Every man's hand is against his neighbor. Banks are in the business to make money under the system which the lawmaking power has constructed, whatever it is. They have and feel no responsibility for the effects on the public which their legal acts may entail. That responsibility they rightly place on the lawmakers. This is shown by their operations under the National Bank Act. When banks in New York were remonstrated with for calling loans on a stringent money-market, thereby aggravating an already demoralized situation, the brutally frank reply was given, "Call loans were made to call." It is considered good banking to keep as near the twenty-five per cent. reserve limit as possible, and rely on squeezing the public to restore delinquent reserves. This is conformity to the law under the restrictive system. The banks are in the saddle. They say in effect, "Let the galled jade wince, our withers are unwrung." Co-operation is a new idea for the banks. Yet it is only reasonable that since the banks owe their lives, that is their charters, to the public will, it is their duty to reciprocate by doing whatever the welfare of the country demands of them. They should be willing to co-operate heartily in any plan that is for the good of the people. It must be remembered that in the history of banking, no reform was ever made at the suggestion of the banks. The strong arm of the Government was needed to carry through the Aldrich-Vree-

land bill, for it was not favored by the banks; to them it was a heart-breaking disappointment. It was freely predicted that the idea of associated banks could never be reported by a Congressional Committee, for who, they said, is behind it? All moneyed interests were opposed to it, and yet it has prevailed only because it is the republican way of solving the currency question.

7. The most important point to be guarded in any expansive system is the contraction needed to restore the power for another expansion. Until the bent bow straightens itself, it cannot shoot another arrow. The capital which moves this year's crops must be returned in time to move the next. Therefore, redemption funds and agencies should be ample. But, more important still, the basis of bank currency should be commercial paper having but a short time to run. The movement of crops and goods to the market is represented by such paper. These are operations which are completed in a few months and are connected with the active business life of the country. Currency is designed to facilitate such business.

It is very evident also, and has been proved often by the experience of our clearing-houses, that, if currency is supplied by associated banks, there is a firm but gentle pressure on the borrowing bank to take up its loan, and repay their advances at the earliest practicable moment. The National Currency Association, which represents the associated banks, is responsible for the payment of the advances, and it desires to end that responsibility as soon as is possible. The movement of the crops takes place in a few months. The money derived from the sale of the crops is then in hand to redeem the notes; and, though redemption may come naturally at the end of the operation, because the currency has done its work, the pressure from the associated banks is needed to enforce redemption, so that an effectual contraction shall take place to restore the power to expand when the next season arrives. The expansive system is safe only if the currency is based chiefly on short-date commercial paper. The restrictive and expansive systems both supply money to move the crops. One does it at the expense of the commercial community, the other at the expense of a little inconvenience to the banks, which, instead of calling loans, will have to go to the National Currency Associations to get whatever their customers need.

A loan from a currency association is not a perquisite which a bank may demand as a right. It is a lawful loan, made subject to the approval of a committee composed of experienced bankers, who have a contingent interest in any loss which may result therefrom. This committee is one remove from the importunity of borrowers, which separation insures calm, deliberate and conservative action. A committee selected from the directors of different banks will, presumably, have acquaintance with the commercial houses of their States, and would be desirous of promoting and developing all legitimate local business interests. Centralization would thereby be avoided. From the above it is concluded that the five to ten per cent. Government tax is unnecessary.

8. The Aldrich-Vreeland bill contains its own confession that it is not a finality. It is like the Constitution of the United States, which, as ratified and made operative, contained the essential principles of our Government. But ten necessary Amendments were added within a few years. So now the framers of this bill have already begun the work of its development into a permanent system. Besides the removal of the oppressive and obstructive tax of five to ten per cent. it would be an improvement to make the system more inclusive. While the national banks should be made pre-eminent and predominant, as they are in the bill, State banks should not be excluded from currency associations, if they conform to the requirements of the National Bank Act as to reserves and in other respects. They might, at least, be made associate members, without the right to vote or hold office.

There is an objection also to corporations which are only to do business occasionally, or perhaps once a year. When they start up, they are apt to be rusty. It would be far better to incorporate our clearing-houses, which are in continuous operation, and with which banks are brought into constant contact. There might be competition or conflict between National Currency Associations and the present clearing-houses. This possibility would be obviated by the inclusion of clearing-houses. In addition to these considerations, it would be well for the business public to have all banking functions brought into one system. Arbitrary and oppressive action by these unincorporated bodies would thereby be prevented.

9. The Aldrich-Vreeland bill for the first time places the expansive system on our statute books. The union of national banks in National Currency Associations follows closely the plan proposed by Robert Hare in 1837. It is also in accord with the dictum on which Henry Dunning McLeod bases his Theory of Credit, and which he states in the following words:

"In the modern system of credit it is indispensably necessary that there should be some source to create and issue solid credit to sustain solvent houses in a monetary panic."

Whatever the defects of this bill, it should be a matter of national rejoicing that this principle has at last been embodied in our banking laws. Defects may be cured by subsequent legislation; but, in spite of them, this law has sufficient power to protect the country against monetary panics in the future. The enactment of the expansive principle in this bill marks an epoch in the history of banking in our country.

The first general banking law the world ever saw was enacted by the legislature of New York in 1838, when the Whig party was in control. The first national banking system was created by Congress in 1861 with the Republican party in control; and now the same party is bringing the work of republican banking legislation to its final and perfect form and logical conclusion.

THEODORE GILMAN.

THE MORALS OF THE MODERN HEROINE.

BY ELIZABETH BISLAND.

FUNDAMENTAL morals alter but little from age to age, some general law of behavior being required to make feasible the life in common. Thou shalt not kill: Thou shalt not steal, nor lie, nor covet thy neighbor's wife, are the four cornerstones of society. But while these basic laws have been what a young Japanese poet—in a moment of lyric ardor—has called “the social glue,” there is no one thing more subject to the vagaries of fashion than the smaller morals, so to speak; those refinements of thought and behavior which form the morals of the non-criminal classes—such folk as ourselves, who have daily to beg that we may not be led into temptation, but who rarely even contemplate any real egregiousness of conduct.

Can one imagine, for example, any two standards farther apart—more separated by the whole diameter of thought—than those of a wealthy young New-Yorker who interests himself in reform work in the East Side slums, and those of a young Roman patrician of the time of the great Julius? And yet both of these men would give adherence to the simpler code, that murder, theft, lying and cowardice were unthinkable temptations. The Roman would look upon the modern sociologist as a fantastic fool, and the earnest young reformer would consider the Italian as no better than a gross and selfish pagan, and yet both would be gentlemen, with a lofty sense of duty.

Of course, these fashions in ethics profoundly affect literature, that mirror of the human mind in which we see reflected not only our own faces, but also the faces of all our ancestors; in which we see depicted our physical and moral lineaments; in which we find the semblance of our ideals and the ideals of those who have created us and our aspirations. When we wish